PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Item 39 ID#3646

ENERGY DIVISION **RESOLUTION E-3875**

September 23, 2004

R E S O L U T I O N

Resolution E-3875. Pacific Gas & Electric (PG&E), Southern California Edison (SCE) and San Diego Gas & Electric (SDG&E) request approval of Agency Agreements with the California Department of Water Resources (DWR) for the implementation of the California Consumer Power and Conservation Financing Authority (CPA) Demand Reserves Partnership (DRP) Program.

By Advice Letters (ALs) 2505-E (PG&E), 1720-E-A (SCE), and 1512-E-A (SDG&E) filed on May 10, 2004.

SUMMARY

The submitted Agency Agreements from PG&E, SCE and SDG&E are denied. The proposed agency agreements submitted by the utilities via their advice letter filings of May 10, 2004 are denied.

Denies Utilities' Proposed DWR Revenue Requirement Increase Trigger The utilities' proposal that DWR include revenue requirement language in the agency agreements is denied as such language is unnecessary.

The Term of Agreements Should End in 2007 Rather than end the term of the agreements in 2004, the agreements should extend to 2007, and the utilities will be able to recover the costs of administering program for post-2004 years.

Utility Liability As Agents for DWR is not Unreasonable DWR is not unreasonable in requiring liability on the part of the utilities as its agents. A cap on liability of $1 million should be accepted by PG&E and SCE, and a prorated amount based on potential capacity should be accepted by SDG&E for its cap.

The Utilities Will Not Penalized for Violating Least-Cost Dispatch Requirements for DRP Reliability Events or For Certain Testing

A previous Assigned Commissioner's Ruling on Least-Cost Dispatch requirements is clarified and affirmed by the Commission. Any reliability event triggered by the program or certain testing events for the program will be exempt from penalties should least-cost dispatch requirements be violated.

DWR and the Utilities Will Negotiate Those Provisions of the Agency Agreements Affected by the Extension to 2007

The utilities are ordered to submit supplemental filings in 15 days to allow them to negotiate with DWR revisions to those provisions affected by the extension of the agreements to 2007.

BACKGROUND

The Demand Reserves Partnership Has Been a Demand Response Resource since 2002.

The Demand Reserves Partnership (DRP) was created in 2002. The foundation of the program is a five-year contract between the California Consumer Power and Conservation Financing Authority (CPA) and the California Department of Water Resources (DWR). The contract functions much like the other power supply contracts signed by DWR on behalf of the utilities by providing power, where and when needed, but through reductions in demand, rather than generation.

There are various supporting contracts, called "Demand Reserves Provider Agreements", which underlie the contract between DWR and the CPA. These contracts, between the CPA and several third-party aggregators, specify the terms and conditions of how aggregators provide power to DWR. The terms of the supporting contracts mirror the terms of the contract between DWR and CPA. The Demand Reserve Providers, in turn, have individual agreements with electricity customers who provide the actual demand reduction.

As currently operated, the contracts provide that, when notified by DWR, customers who were consuming power in the normal course of business, curtail their load and make power available for the customers of the utilities. An electronic notification is sent from DWR, to the CPA (and its contractor Automated Power Exchange (APX)), to the aggregators and finally to the customers. In exchange for the reduction in load, participants are paid a

monthly capacity payment (based on the amount of load committed for reduction) along with an energy payment (actual amount of energy reduced) when the program is triggered.

The contract between DWR and CPA allow DWR to trigger the program during high wholesale market prices or when energy supplies are short. To date, the program has been triggered by DWR only for reliability and testing purposes. The program operates year-round, but is designed to focus on the summer months. In Summer 2002, the program's capability was 15 megawatts (MW) of capacity; by Summer 2003, the program's capability had increased to 249 MWs. The contract between DWR and CPA provides for three more summers of operation (2004, 2005 and 2006).

The Commission Ordered the Utilities to File Implementation Plans for the DRP

In D.03-06-032, the Commission recognized the DRP as a viable and important program, and directed PG&E, SCE and SDG&E (the utilities) to coordinate their scheduling activities with the CPA to ensure that the DRP resources are actually dispatched when it is cost effective to do so. The utilities were specifically ordered to file implementation plans detailing how they will use the DRP resource effectively.

In compliance with D.03-06-032, the utilities filed advice letters containing their implementation plans on July 7, 2003. In these advice letters the utilities reported that they must have agency agreements with DWR that enables them to schedule and dispatch of DRP resources on behalf of DWR, essentially allowing them to operate as DWR's limited agents. At the time of their July filings, the utilities reported that negotiations with DWR were initiated and that final agency agreements were targeted for mid-July.

However for the remainder of 2003, the utilities and DWR were unsuccessful in developing the agency agreements as the negotiations between them could not resolve their differences on certain issues.

The Commission provided Guidance to the Utilities and DWR Regarding the Agency Agreements

On January 26, 2004, an ALJ ruling was issued directing the utilities to file status reports on the impediments to executing the proposed agency agreements. DWR and the CPA were encouraged to file status reports as well. Each utility

complied with the ruling, and DWR submitted its status report. Several parties filed comments regarding the status reports.[1]

On April 1, 2004, an Assigned Commissioner's Ruling (ACR) was issued providing guidance on the impediments discussed in the reports and comments. The primary issue addressed in the ruling was absolving the utilities of least-cost dispatch requirements should DWR trigger the program for reliability or testing purposes as part of its statutory responsibility. That ruling also ordered the utilities to resume negotiations with DWR, finalize agency agreements with the department, and submit final agency agreements via supplemental advice letters.

In response to a memorandum from DWR dated April 26, 2004, a second ACR was issued on May 3, 2004, providing additional clarification on the issue of testing the DRP in relation to least-cost dispatch requirements.

The Utilities and DWR Have Not Finalized their Agency Agreements

As directed by the ACRs, the utilities filed their proposed agency agreements via advice letter on May 10, 2004. However each utility noted in its filing that it was unable to resolve every issue with DWR, and thus the agency agreements, as proposed in their filings, have not been agreed to by DWR. Each utility argues that in spite of the remaining differences with DWR, the Commission should adopt the agency agreements as proposed in their respective advice letters.

NOTICE

Notice of AL 2505-E, AL 1720-E and AL 1512-E-A were made by publication in the Commission's Daily Calendar. The utilities state that a copy of their AL was mailed and distributed in accordance with Section III-G of General Order 96-A.

PROTESTS

DWR submitted a memorandum dated May 10, 2004 providing comments on the major unresolved issue between itself and the utilities. The memorandum also

[1] DWR, CPA, APX, Celerity Energy, Onsite Energy Corp., Ancillary Services Coalition, DBS Industries, and Excel Energy Technologies, Ltd., filed comments.

included a draft Agency Agreement that DWR recommends for adoption. In effect, DWR's memorandum is a protest to the utilities' advice letters. On May 11, DWR sent a revised draft of their recommended Agency Agreement, stating that they inadvertently sent an incorrect version on May 10.

The utilities responded to DWR's protest on May 17 and 18, 2004.[2]

DWR submitted a memorandum dated May 20, 2004 in response to both the utilities' advice letters filing and the utilities' May 17 and 18 responses.

DISCUSSION

The Revenue Requirement Language Proposed by the Utilities is Unnecessary

The primary issue between DWR and all three utilities revolves around certain language that the utilities insist be included in Section 9.04 of their agency agreements with DWR. That language would require DWR to pursue an increase to its revenue requirement if moneys in its Electric Power Fund are insufficient to pay amounts owing under the agency agreement. The specific language proposed by PG&E is as follows:

> "If moneys on deposit in the Fund are insufficient to pay all amounts payable by DWR under this Agreement, or if DWR has reason to believe such funds may become insufficient to pay all amounts payable by DWR under this Agreement, DWR shall diligently pursue an increase to its revenue requirements as permitted under the Act from the appropriate Governmental Authority as soon as practicable."

According to the utilities, this language is reasonable and is also identical to that found in their respective operating agreements or servicing orders with DWR. PG&E noted that absent the disputed language, if money in the Electric Power Fund were depleted, DWR could refuse to pay amounts owing to PG&E under the agency agreement without breaching the agreement. In their response comments, the utilities proposed a simplified version of the quoted text.

[2] PG&E and SCE filed their responses on May 17, while SDG&E filed its response on May 18.

DWR is opposed to the inclusion of the language on the basis that it already has a statutory duty to revise its revenue requirement under specific triggering situations and circumstances described in its Rate Agreement and bond indenture. DWR believes it is inappropriate to create a separate right for the utilities to dictate a revision to DWR's revenue requirement for the DRP, especially when the program represents an extremely small portion of DWR's overall revenue requirement. DWR notes that as a practical matter, it would revise its revenue requirement if it foresaw that there were insufficient funds to cover amounts it must pay under its contracts, but it is not willing to grant separate and independent obligations to every party to a contract it has.

We agree with DWR that it is not necessary to include the language proposed by the utilities in their respective agency agreements for the DRP. The costs of the DRP are indeed a small portion of DWR's overall revenue requirement, and we agree with DWR that most of the costs that DWR is obligated to cover are payments from DWR to the CPA for costs pursuant to the Demand Reserves Partnership Agreement. We are confident that DWR will take whatever appropriate actions available to it to ensure that there are sufficient funds to cover the amounts it owes the utilities under the agency agreements.

The Term of the Agency Agreement Should End in 2007

In its May 10 memorandum DWR proposed that the agency agreements with the utilities should extend through May 17, 2007. The utilities claim that their negotiations with DWR to date have been under the assumption that the term of the agreements ends on December 31, 2004. Notwithstanding their concern that this issue was just recently raised by DWR, the utilities are generally amenable to a term ending on May 17, 2007 provided that they have the opportunity to modify other provisions in the agency agreements that are affected by the new date. PG&E notes that the modifications are expected to be minor in nature. We will grant the utilities and DWR 15 days from the effective date of this resolution to file final agency agreements, which is ample time to make any other modifications.

The most prudent course of action is make the term of the agreements extend up to May 17, 2007 as proposed by DWR, rather than December 31, 2004. It is our view that there has been too much time expended in negotiating the agreements and based our observations to date, re-starting negotiations on new agreements for 2005 is will be time-consuming and possibly lead to delays in implementing the DRP that year.

Each utility has been authorized to recover administrative, software development and capital costs for administering the DRP program for 2003 and 2004 via D.03-06-032. In their comments on the draft resolution, the utilities state they will need a mechanism for cost recovery if the Commission extends the term of the agreements with DWR beyond 2004. The utilities also suggest that they be allowed to spend any unused funds from 2003 and 2004 in future years.

We find that the utilities' request for recovery of DRP costs for subsequent years beyond 2004 is reasonable, and we will also allow unused funds to be used for years 2005-2007. We decline to adopt a specific budget amount for post-2004 DRP costs in this resolution, and direct the utilities to request additional funds for years 2005-2007 in the demand response rulemaking (R.02-06-001) or its successor rulemaking.

Utility Liability As Agents for DWR is not Unreasonable

Both SDG&E and SCE report that they have not reached agreement with DWR regarding the issue of liability. DWR seeks to make the utilities liable (with a cap on that liability) on the basis that agents are commonly liable to their principals under commercial agency agreements. PG&E does not oppose liability as DWR's agent, and has agreed to a liability cap of $1 million.

SDG&E appears to accept the principle of liability as DWR's agent, but was unable to reach an agreement with DWR regarding a cap amount for the liability. Specifically, SDG&E proposes that its liability cap be calculated at a rate of $10,000 per MWh of capacity allocated to SDG&E's territory, with a minimum of $50,000 and a maximum of $200,000 over the term of the agency agreement.

SCE reports that it has a more fundamental issue, stating that it should not be required to accept any liability as an agent for DWR since the agency agreement does not approximate a standard commercial agreement and that accepting liability makes SCE liable to two masters (DWR and the CPUC). SCE also notes that DWR insists that SCE verify invoices from DWR's counterparty, which it may be willing to do if SCE is not required to accept liability in the agency agreement.

While the agency agreement is not a typical commercial agreement, it is a commercial agreement nonetheless and DWR is not unreasonable in requiring liability on the part of the utilities as its agents. Therefore SCE's fundamental

position on this issue is rejected. Regarding the cap on liability, we direct SCE to accept a cap on liability equal to that accepted by PG&E: $1 million. SDG&E's cap on liability should be a portion of $1 million based on 2003 peak demand in its territory in comparison to the 2003 peak demand of the other two utilities.

SCE Should Verify the CPA's Invoices to DWR As Part of Its Tasks of Administering the Program

We clarify that SCE should verify the CPA's invoices to DWR as part of its responsibilities in administering the DRP. In its comments on the draft resolution, SCE considers invoice verification to be a new task unrelated to the schedule and dispatch of DRP resources, even though we stated "the IOUs must coordinate their customer, meter, scheduling and settlement activities in a manner that maximizes the full potential of the CPA DRP."[3] SCE appears to be alone in its perspective as neither PG&E nor SDG&E have objected to invoice verification as an additional task not previously ordered by the Commission.

SCE further claims that it will need additional cost recovery for the "considerable expense" to undertake the task of invoice verification. SCE claims that there could be potentially hundreds or thousands of accounts participating in the DRP, but that assumes that certain changes in the program will occur. We decline at this time to authorize additional funding for SCE for the task of verifying invoices. We recognize that the DRP could be modified in a way that increases enrollment, or that enrollment may simply grow without program changes, either of which could result in significant costs for invoice verification. We therefore allow the utilities to demonstrate the need for additional funds for invoice verification in the demand response proceeding (R.02-06-001) or its successor rulemaking.

[3] D.03-06-032, pg. 32.

The Utilities Will Not Be Penalized for Violating Least-Cost Dispatch Requirements for DRP Reliability Events or For Certain Testing

PG&E states in its advice letter that the May 3 ACR could be interpreted to mean that the utilities would be protected from least-cost dispatch penalties for only four hours per month for testing and reliability events. PG&E states that it and the other parties have interpreted the ruling to mean that the four-hour limitation applies only to testing.

In response to the utilities' comments on the draft resolution, we affirm the guidance provided by the ACR on the issue of protection from least-cost dispatch penalties: the utilities will not be penalized for violating least-cost dispatch requirements if DWR instructs them to dispatch the DRP resources for (1) any reliability event (regardless of its length) or (2) for testing purposes that are limited to (a) once per month, (b) no more than four hours in length, and (c) when the program has not already been called that month.

COMMENTS

Public Utilities Code section 311(g)(1) provides that this resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission.

SCE, PG&E and SDG&E filed comments on June 24, 2004 and DWR filed reply comments on July 1, 2004.

All three utilities request a cost recovery mechanism for administering the DRP if the Commission extends the term of the agreement from 2004 to 2007. We find that request reasonable and grant authorization for recovery.

All three utilities request further clarification of when they would be protected from least-cost dispatch penalties and further request that the Commission affirms its agreement with the guidance provided in April 1 and May 3 ACRs. We clarify and affirm the guidance provided in the ACRs in the Discussion section.

SCE requests clarification that it is expected to verify invoices from the CPA to DWR. We clarify this issue as well as the issue of cost recovery for this task.

Both SCE and PG&E dispute that the agency agreements with DWR are "commercial" agreements and thus should not be used as the basis for imposing the risk of liability on the utilities. SCE further notes that since it has not been able to come to an agreement with DWR, the Commission should order the utilities to implement the DRP program through an operating order. We disagree with SCE and PG&E on this issue, and no changes have been made to the resolution on this issue.

PG&E argues that the disputed language concerning DWR's revenue requirement should be made part of the agency agreements. We decline to make this change for the reasons already discussed.

DWR commented that a liability cap of $1 million is the minimum acceptable liability cap for DWR, which affords the same level of protection for each utility. We decline to adopt a $1 million liability cap for SDG&E, and encourage DWR and SDG&E to calculate a liability cap according to the guidance provided above.

DWR also commented on the task of invoice verification, and we agree with those comments.

FINDINGS

1. The Demand Reserves Partnership (DRP), created in 2002, is based upon a five-year contract between the California Consumer Power and Conservation Financing Authority (CPA) and the California Department of Water Resources (DWR).

2. The DRP contract functions much like the other power supply contracts signed by DWR on behalf of the utilities by providing power, where and when needed, but through reductions in demand, rather than generation.

3. "Demand Reserves Provider Agreements", which underlie the contract between DWR and the CPA, specify the terms and conditions of how aggregators provide power to DWR.

4. In exchange for the reduction in load, participants in the DRP are paid a monthly capacity payment (based on the amount of load committed for

reduction) along with an energy payment (actual amount of energy reduced) when the program is triggered.

5. To date, the DRP has been triggered by DWR only for reliability and testing purposes.

6. In D.03-06-032, the Commission recognized the DRP as a viable and important program, and directed PG&E, SCE and SDG&E to coordinate their scheduling activities with the CPA to ensure that the DRP resources are actually dispatched when it is cost effective to do so.

7. The utilities and DWR have been unsuccessful in developing agency agreements that enable the utilities to operate as DWR's limited agents for the DRP.

8. On April 1 and May 3, 2004, ACRs were issued that provided guidance to the utilities and DWR regarding impediments to the finalization of their agency agreements.

9. As of May 10, 2004, the utilities and DWR have not been able to finalize their agency agreements, and each utility urges the Commission to adopt their proposed agency agreements as submitted in their filings on May 10. DWR urges adoption of their proposed agency agreement submitted on May 11.

10. DWR protested the utilities' May 10 filings and the utilities' responded to DWR's protest on May 17 and 18, 2004. DWR submitted a memorandum on May 20, 2004 in response to both the utilities' May 10 filings and their protest responses.

11. The revenue requirement language proposed by the utilities for Section 9.04 of their respective agency agreements with DWR is unnecessary.

12. The term of the agency agreements should extend up to May 17, 2007 as proposed by DWR, rather than December 31, 2004 once the requisite modifications are made.

13. The utilities should track all expenses incurred in administering the DRP Program under the agency agreements in their respective AMDRMA or appropriate successor memorandum accounts. In addition, the utilities are

authorized to carry over any unspent 2003-2004 funding related to the DRP Program to apply towards funding in 2005-2007 that will be approved by the Commission in a future budget authorization. The utilities may also request additional funds for years 2005-2007 in the demand response rulemaking (R.02-06-001) or its successor rulemaking.

14. SCE's fundamental position on the issue of liability is rejected.

15. SCE should accept a cap on liability equal to that accepted by PG&E: $1 million.

16. SDG&E's cap on liability should be a portion of $1 million based on 2003 peak demand in its territory in comparison to the 2003 peak demand of the other two utilities.

17. The utilities should verify the CPA's invoices to DWR as part of their responsibilities in administering the DRP.

18. SCE's request for additional funding for the task of verifying invoices is denied at this time.

19. The utilities may demonstrate their need for additional funds for invoice verification in the demand response proceeding (R.02-06-001) or its successor rulemaking if the DRP is modified in a way that increases enrollment, or if enrollment grows, without program changes, to an extent that results in significant costs for invoice verification.

20. The utilities will not be penalized for violating least-cost dispatch requirements if DWR instructs them to dispatch the DRP resources for (1) any reliability event (regardless of its length) or (2) for testing purposes that are limited to (a) once per month, (b) no more than four hours in length, and (c) when the program has not already been called that month.

21. The proposed Agency Agreement as submitted by DWR should be modified by DWR and the utilities to accommodate those provisions affected by the term extension to May 17, 2007.

22. DWR's protest is granted.

THEREFORE IT IS ORDERED THAT:

1. DWR's protest is granted.

2. The agency agreement as proposed by DWR on May 11, 2004 should be modified by DWR and the utilities to accommodate those provisions affected by a term ending on May 17, 2007.

3. The utilities shall file supplemental advice letters with finalized agency agreements that comply with the findings of this resolution within 15 days of the effective date of this resolution.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on September 23, 2004; the following Commissioners voting favorably thereon:

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STEVE LARSON
Deputy Executive Director